# EXPLANATORY MEMORANDUM TO

# THE FRIENDLY SOCIETIES (MODIFICATIONS OF THE TAX ACTS) REGULATIONS 2012

## 2012 No. 3008

**1.** This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) on behalf of Her Majesty’s Treasury and is laid before the House of Commons by Command of Her Majesty.

## 2. Purpose of the instrument

2.1 The Finance Act 2012 introduced a new corporate tax regime for life insurance companies and friendly societies to have effect from 1 January 2013. That legislation provides that the Corporation Tax Acts apply to life insurance and other long-term business carried on by friendly societies as they do to such business carried on by mutual insurance companies. However, it also provides for those rules to be modified to accommodate certain types of tax exempt business carried on by friendly societies. This instrument makes such modifications to the life insurance rules as they apply to friendly societies.

## 3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 None

## 4. Legislative Context

4.1 The taxation of life insurance companies is currently based on regulatory returns made to the Financial Services Authority (FSA). The current legislation, which makes frequent and specific references to the FSA return, is largely contained within Chapter 1 of Part 12 of the Income and Corporation Taxes Act 1988 and Chapter 1 of Part II of the Finance Act 1989. The European Union Solvency II Directive (Solvency II) will, when it comes into force, fundamentally change the regulatory framework which applies to life insurance companies. As a result of these changes, regulatory returns made to the FSA will no longer provide the information necessary to make the current legislation work.

4.2 Part 2 of the Finance Act 2012 therefore introduces a new regime for the taxation of life companies, based on statutory accounts, as is the case for companies generally. Part 3 modifies those rules to apply to friendly societies; in particular, it continues the current exemption from corporation tax of profits on certain types of business written by friendly societies. This instrument sets out further, more detailed, modifications to the rules to ensure that tax exempt business is appropriately treated.

4.3 There are a number of existing regulations, which modify the current life insurance legislation for friendly societies; these will be revoked as from 1 January 2013, when this instrument comes into force.

## 5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

## 6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

## 7. Policy background

- ***What is being done and why***

7.1 At Budget 2011 the Government announced the main features of a new corporate tax regime for life insurers and friendly societies, to apply from 1 January 2013.

7.2 Changes under the new regime are fundamental and extensive. The main change is that, in anticipation of the regulatory Solvency II changes, trading profits will, for tax purposes, be calculated on the basis of life companies' statutory accounts, in line with general tax rules. Currently, these profits are derived from information provided in regulatory returns made to the FSA.

7.3 The new regime also establishes, for insurance companies, two categories of long-term business, to which different tax treatments are applied. These categories are known as “basic life assurance and general annuity business” (BLAGAB) and “other long-term business”.

7.4 Friendly societies are currently exempted from corporation tax on profits from certain types of business provided that the premiums paid by the policyholders do not exceed certain limits. The new regime maintains those exemptions unchanged. It does this by establishing, for friendly societies only, a third category of business, known as “tax exempt business”.

7.5 This instrument provides detailed modifications to the rules in Part 2 of the Finance Act 2012 to accommodate this third category of business.

- **Consolidation**

7.6 There are no relevant instruments to consolidate. Previous instruments which set out special rules for friendly societies under the current regime are revoked. The new Regulations are significantly less complex than those they replace, which amount to some 38 pages.

## 8. Consultation outcome

8.1 The government has consulted extensively, formally and informally, to ensure that the new tax regime for life companies and friendly societies will operate fairly and effectively. A formal consultation on the new regime took place between 5 April and 28 July 2011. A summary of responses was published on 6 December 2011, alongside draft primary legislation. That draft was developed into the legislation included in the Finance Act 2012.

8.2 Since April 2012, drafts of this instrument have been shared with industry representatives and advisers; they have been discussed in detail at a series of meetings of a joint working group established by HMRC and the industry specifically to address issues arising in the friendly society and mutual insurance sectors. In addition, a draft of this instrument was published for comment, in accordance with HMRC's Tax Consultation Framework (http://www.hmrc.gov.uk/consultations/tax-consultation-framework.pdf), for a period of four weeks starting on 22 October 2012. Comments on the published draft instrument identified some refinements, but no substantive changes were necessary.

8.3 This process has enabled HMRC to develop these Regulations in partnership with interested stakeholders, from whom extensive assistance and input has been received. These contributions have resulted in Regulations which stakeholders, including the main industry representative bodies, support. They are generally regarded as appropriately focused, aligned to commercial realities, and as an effective basis for the taxation of friendly societies.

## 9. Guidance

9.1 Guidance on the new regime, including the application of this instrument, will be made available on the HMRC website.

## 10. Impact

10.1 The scope of these Regulations is restricted to friendly societies, of which there are approximately 100. However, of these less than 40 will in fact be affected, as the remainder do not carry on the tax exempt business with which the Regulations are concerned. There is no impact on charities, the voluntary sector or the public sector.

10.2 There will be some one-off familiarisation and training costs for tax specialists in affected businesses. The impact on compliance and ongoing annual administrative costs will be negligible.

10.3 A Tax Information and Impact Note covering this instrument was published on 6 December 2011 alongside draft clauses for the 2012 Finance Bill, and is available at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

## 11. Regulating small business

11.1 The new life insurance tax rules may affect up to 30 friendly societies classified as small firms (that is, with fewer than 20 employees). These have to be included in the measure as the new tax regime applies to the sector as a whole. However, the impact of these Regulations on those firms will be low, since they primarily serve to continue the existing tax exempt treatment of the appropriate types of business.

11.2 The main representative body for Friendly Societies has been fully engaged in consultation.

## 12. Monitoring & review

12.1 HMRC has an established programme of liaison with the life insurance industry, and the friendly society sector in particular, which will capture issues around the operation of the new regime, including this instrument. No special data should be needed for monitoring; tax returns will provide the information required to make an assessment of the tax impact of the new rules.

## 13. Contact

13.1 **Andy Stewardson** at the HM Revenue & Customs Tel: 0207 147 2600 or email: andy.stewardson@hmrc.gsi.gov.uk can answer any queries regarding the instrument.